Under reconstruction! We apologize for the absence of certain materials.

EU-UKRAINE-RUSSIA: FURTHER GAS DIALOG AS A GUARANTEE OF EUROPE'S ENERGY SECURITY

30 October 2002

The EU-Russia and EU-Ukraine energy dialog, primarily on cooperation in the gas sector, is taking a more concrete turn. At an EU-Russia Paris summit about two years ago, President of the European Commission Romano Prodi announced the start of regular consultations in the energy field between Brussels and Moscow. The advance of this dialog, which has since come to be known as the Prodi Initiative, provides for broader cooperation between the EU and Russia in the energy field and for a two-fold increase in the supply of Russian natural gas to the EU countries.

The European Union, Russia and Ukraine have long engaged in fruitful cooperation in this field. Unfortunately, parallel negotiations between the three parties instead of tripartite talks within the "gas triangle" (in which the EU is the principal gas consumer, Ukraine, the major transit country, and Russia, the leading supplier), and also the EU bias toward Moscow tend to hold back the development of this cooperation. In addition, a more effective dialog is impeded by the absence of structural reforms in the fuel and energy complexes of Russia and Ukraine.

An analysis of the new energy strategy of the EU and Russia shows that in the medium term the EU will increase its imports of Russian gas while seeking to diversify its supply routes, which could create serious problems for Ukraine as a transit country.

Under a special project, the Razumkov Center has carried out a study of the main trends in the development of the Eurasian gas market, in longterm gas production and transportation projects in the Ukrainian zone of interest, and the state and capabilities of the Ukrainian gas transport system (GTS). This material has been discussed, in particular, at a roundtable entitled "EU-Ukraine-Russia Gas Triangle: Unity and Clash of Interests," held in Kiev on 9 April with the support of the International Renaissance Foundation. It was attended by Ukrainian MPs, officers of the presidential administration, the National Security and Defense Council, and various ministries and agencies, representatives of oil and gas companies, nongovernmental organizations and foreign embassies, experts and journalists. The problems raised at the roundtable form the basis of this article.

Global Energy Market Trends

An analysis of the development of the world energy market shows a steady increase in the use of energy resources, especially natural gas. In 2000, for example, its consumption rose by 4.3% compared with 1% for oil and 1.2% for coal. This trend is due, first and foremost, to the advantages of "blue fuel" as an environmentally clean energy resource available at stable prices.

The coming decades will be marked by intensive development of the gas industry in all the market participants. The growing use of gas and a rise in its share in the energy balances of importing countries will induce them to diversify gas supply sources and routes in order to avert the threat of dependence on a single supplier.

This process will be spurred as new exporters-countries of the Caspian region-enter the world market. This, however, will take a long time and will require substantial investments in the development of gas fields and the construction of pipelines.

The current trends in the gas industry, in the development of major gas fields and exploration of the most promising deposits show that in the long-term perspective we can expect an intensive development of the Eurasian gas market, since the demand for gas in most countries of Europe and the Asia-Pacific Region (APR) is bound to increase. The main potential for the supply of gas to Europe is concentrated in Russia, Norway, the countries of the Middle East and the Caspian region.

The largest share of the European Union's demand for gas imports is being met by Russia, with almost 90% of its gas supplies to the EU and candidate countries passing through the territory of Ukraine.

Against the background of instability in world raw material markets, Moscow has been trying to convince the West that cooperation with it is very promising, and has been carrying on an energy dialog with the U.S.A. and at G-8 and EU forums.

The European Union Counts on Russian Gas

Rising gas consumption is due to such factors as the prospect of a closure of nuclear power plants in some EU countries, the need to supply gas to some EU regions which have not been getting it for economic reasons, and the forthcoming enlargement of the Union. The increase in the share of gas in the EU energy balance has been quite dynamic: from under 2% in 1960 to over 22% in 2000; by 2030, it is expected to reach 29%.

In view of these trends, a new energy strategy for the European Union was developed in 2000-2001. The European Commission has also prepared a package of documents on the development of gas transportation networks. All these data confirm that gas consumption is bound to grow, while a decline in its production within the EU, primarily in the North Sea, will increase the Union's dependence on gas imports from other sources. One can expect the share of gas imports to go up from 39% in 2000 to 67% in 2020, and considering EU enlargement, to 73%.

The main suppliers of gas to the EU countries today are Russia, Algeria and Norway, and insignificant amounts are also being imported from Libya and Egypt. Russia exports gas to six EU countries and accounts for a sizeable share of their imports. In addition, virtually all the import requirements of five of the seven Central and East European candidates for EU accession are also being met by Russia.

A significant increase in deliveries from Norway and Algeria is highly problematic: the North Sea reserves are limited and their extraction is fairly expensive, whereas Algeria has large gas deposits, but an increase in gas exports is being held back by the need to build underwater gas pipelines, which are much more costly than above-ground pipelines.

Russia is potentially able to step up supplies to the EU. Experts believe, however, that the rise in demand could outpace its ability to meet that demand.

Such a situation induces the EU to look for new sources, for example, in the Caspian countries and Iran. The cost of gas from these countries will be much higher than from Algeria because of longer distances, but the need to diversify sources outweighs purely economic benefits.

So, in the view of EU specialists, Russia is the most promising partner in this respect. At the same time, in order to avoid the danger of short supply and to diversify its suppliers, the Union is planning to build gas pipelines from the Caspian countries bypassing Russia's territory, and also to import gas from Iran and Iraq.

An analysis of the European Union's long-term gas projects, and also of projects tentatively designated as priority ones invites the following conclusions: the EU intends to diversify its supply sources, as indicated by the priority status it has given to the project for the construction of a new gas network linking the Caspian countries, the Middle East and the EU; Moscow's role as a major supplier of gas to the EU will be maintained and will even be enhanced, as confirmed by the inclusion in the list of priorities of the project for the construction of Russia-Germany gas networks. The Union is also planning to increase the role of new transit countries for Russian gas (projects to enhance the throughput capacity of gas pipelines routed from Russian fields to the EU through Belarus and Poland).

One should note that these projects do not provide for Ukrainian participation, which may be explained by the above-mentioned urge to diversify supply routes. At the same time, the project for building pipelines from the Caspian countries could be of interest to Ukraine, and the initial phase of work on this pipeline option does not in effect rule out the prospect of Ukraine's involvement in it. There are three projects with Kiev's participation in the overall list, but today only one of them is being partly implemented, whereas the other two are mere statements of intent.

If the construction of Russia-EU gas pipelines bypassing the territory of Ukraine gets underway without a parallel buildup of gas production on Russia's part, this could have negative consequences for Ukraine (a decline in the transit volumes of Russian gas as the result of a redistribution of its export flows to new pipelines).

EU-Russia Cooperation: Russian Gas in Exchange for Western Investment

The European Union and Russia have recognized their interdependence in the energy field. Over the next 20 years, this interdependence in the gas sector is bound to increase: the EU wants to see a radical expansion of Russian gas supplies, while the Russian gas industry is in need of huge investments to develop new deposits, to modernize existing and build new pipelines, and to introduce new energy-efficient technologies. On that basis, the EU and Russia have been carrying on a fairly active energy dialog. The EU is aiming to gain access to Russian mineral resources on its own terms, that is, to secure a stake in the reformed natural monopolies (RAO Unified Energy Systems and OAO Gazprom) and to get Russia to ratify the Energy Charter Treaty (ECT), which would enable other gas producers in the CIS countries to enter the European market. Moscow, for its part, believes that the energy dialog should ensure free access for Russian oil and gas companies to Western financial resources, because today these companies receive Western credits at much higher interest rates than European companies.

The EU-Russia energy dialog centers around four projects: construction of a gas pipeline link from Poland to Slovakia, expansion of the Yamal-Europe main pipeline, construction of a North European pipeline (Baltic Sea), and development of the Shtokmanovskoie field (continental shelf of the Barents Sea). A transition to cooperation in implementing joint production and major gas pipeline projects is impeded by a number of economic factors, and this induces both partners to look for alternatives: the EU, for new supply sources,

production and major gas pipeline projects is impeded by a number of economic factors, and this induces both partners to look for alternatives: the EU, for new supply sources, and Russia, for new sales markets.

The European Union is dissatisfied with the unfavorable investment climate in Russia and the low pace of reform in its energy sector. That is why the EU is not planning over the short term to invest in the construction of gas pipelines in Russian territory or in the development of Russian deposits. In addition, its legislation restricts the funding of non-member countries on the part of EU credit institutions.

Moscow does not agree with two basic EU conditions regarding the liberalization of energy markets: the ECT provision on free and competitive access to transit gas pipelines, and the restrictions on long-term contracts for gas supply with a transition to short-term contracts. The development of Russian gas fields requires large capital investments, and their recovery, in the view of Gazprom specialists, can be guaranteed only under long-term contracts.

The alternative to an expansion of supplies to the EU is the so-called "Eastern vector" of Russian gas policy, i.e., a change in its priority export orientation from the European market to APR markets, including China, which has been developing very rapidly. The first steps have already been taken along the "Eastern vector:" on 17 December, 2001, the Gazprom Board of Directors approved a program to that effect.

All these economic factors are undoubtedly weighty. At the same time, many experts believe that the energy dialog is mainly obstructed by political considerations. The EU is still reluctant to take the risk of large-scale investment in Russia in view of major political risks, while the RF (under pressure from "patriots" who say the West is trying to get hold of the country's national wealth) does not think it possible to give Western companies wide access to its resources.

Cooperation in the energy sector cannot be singled out from the overall context of EU-Russia relations. A real breakthrough in the energy dialog can only occur when the partners get down to full-fledged interaction both in politics and economics. At the same time, given their considerable interdependence in the gas sector, there is reason to believe that the partners will settle for a compromise and concentrate their efforts on expanding Russian gas supply to Europe.

EU-Ukraine Cooperation: Energy Dialog Just Beginning

In the field of gas transit, cooperation between the EU and Ukraine until 2001 was fairly limited. That was due, first of all, to the general orientation of the EU energy strategy toward priority support of producers compared with transitors and toward a diversification of energy supply routes, that is, toward ending any monopoly on transit, including that of Ukraine. International cooperation in this area was also adversely affected by some loss of confidence in Ukraine as a partner in the field of gas transportation because ofunsanctioned use of transit gas, delays in payments for Russian blue fuel, lack of management transparency, and the poor technical state of the Ukrainian gas transport system.

Real cooperation was confined to insignificant financial support of individual projects. Probably the only exception was the INOGATE program, under which tangible projects were carried out (and are now in progress) to modernize the Ukrainian GTS.

The fact that projects connected with a buildup of GTS capacity in the republic have been put on the EU list of priorities shows that the Union eventually plans to expand the Ukrainian route for the supply of Russian gas to the EU and to invigorate cooperation with Kiev.

In 2001, Ukraine and the EU started a dialog on these problems. Thus, at a joint summit in Yalta in September 2001 they decided to set up a working group on matters of reforming the republic's gas transport system. Later that September, a meeting was held in New York between Ukraine and the EU Three (at foreign ministers' level), where various aspects of cooperation in the energy field were discussed in the context of other debatable issues. In January 2002, the first meeting of the joint Ukraine-EU subcommittee on ways of reforming Ukraine's gas transport system dealt with technical, financial, economic and legal aspects of the problem. In March 2002, a regular meeting of the Ukraine-EU Council expressed satisfaction at the progress of the energy dialog and emphasized that the use of Ukraine's transit capacity in providing the EU with energy resources was a common priority.

In addition, a number of gas metering stations are being built in Ukraine under the EU's INOGATE program: in October 2001, the Grebeniki Station was put into operation in the Odessa Region; a Metro-logical Center designed to calibrate and service working standards for checking gas metering devices in the territory of the republic is being built in Boyarka, Kiev Region; and an international technical and economic audit of the Ukrainian GTS is being carried out to chart the ways of its integration with European gas transport systems.

Russian Gas Industry: More Pipelines Than Gas

Russia's gas industry has a high export capacity in view of its large gas deposits, developed production and transport infrastructure, and highly skilled personnel. The entire Russian gas sector is in the hands of OAO Gazprom. Virtually the whole of Russia's gas sector is in the hands of OAO Gazprom.

Russia has about one-third of the world's proven gas reserves (49 trillion cubic meters), with almost 80% of these located in Western Siberia. The most promising fields lie in Yamal and on the continental shelf of the Barents and Kara seas.

But today geological exploration work is being scaled down, productive capacities are beginning to go out of use as a result of full or partial depletion of explored fields, and the increase in gas reserves does not ensure their simple reproduction. This leads to a decline in gas production and to gas shortages on the domestic market. Investment in the gas industry is inadequate for its development, mostly serving to maintain the existing level of production and transportation.

The key projects (now at various stages of implementation) include the construction of the Yamal-Europe gas pipeline system, the Poland-Slovakia pipeline link (which is in fact an element of the Yamal-Europe project), the Blue Stream pipeline for supplying gas to Turkey, and the North European pipeline. The latter practically does not affect the interests of Ukraine as a transit country for Russian gas, whereas the rest-under unfavorable circumstances-could have a negative effect on the volume of transit through the territory of the republic.

The Yamal-Europe main pipeline is the best-prepared project which makes economic sense and meets the European Union's growing needs. It covers both production (development of fields on the Yamal Peninsula) and transportation (construction of twin pipelines, each with a capacity 30 Bern a year). Accordingly, the construction is to be carried out in two stages. Today the building of the first line is nearing completion, and the Belarus-Poland segment of the pipeline was completed in September 1999.

At the same time, given high development and transportation costs, the supply of Yamal gas to Europe is insufficiently profitable. In view of this circumstance and for lack of funds, the development of the Yamal fields has not yet started.

Poland and Germany today have no need for a significant increase in gas supply, so that the completion even of the first stage of the Yamal-Europe pipeline is being delayed, with the result that the transport part of the project is being reoriented toward gas from fields already under exploitation.

In view of the scarcity of financial resources and the fairly high cost of gas extraction in Yamal, the Yamal-Europe project has been transformed into a project for the construction of a pipeline link from Poland to Slovakia (Kobrin-VeIke Kapoushany) for piping gas already being extracted in the Yamalo-Nenets Autonomous Area (and not on the Yamal Peninsula) from Ukrainian to Belarus-Polish pipelines. The link is to have the same configuration and capacity as the Yamal-Europe pipeline: two lines carrying 30 Bern a year each. It is expected to reach full capacity in 2007 (the first line by 2004, and the second, by 2007). The project is being lobbied by Gazprom with the support of the EU and European oil and gas companies (Gaz de France, Italy's ENI, and Germany's Ruhrgas AG and Wintershall AG). The project participants have signed a Memorandum of Understanding and have set up a Consortium for the construction of the pipeline.

In February 2002, Russia's mass media reported that Gazprom had decided not to build the pipeline link, but according to Ruhrgas sources the preparation of the feasibility study is being continued. On its basis, the parties are to take a final decision on the construction of the link, on funding arrangements and, accordingly, on the ownership of Consortium shares.

The Blue Stream pipeline, as one that bypasses Ukraine, affects its interests as well. Should this pipeline reach full capacity without a corresponding increase in the production of Russian gas (16 Bcm a year), the gas flows that used to traverse Ukraine could be redistributed and the republic could lose these transit volumes.

An analysis of Russian gas projects and a comparison of their cost with Russia's real capabilities shows that such projects should envisage a simultaneous buildup of production and transport facilities. This would make it possible to use the newly built pipelines for carrying gas from new fields and would not prejudice Ukraine's transit interests.

However, the decline in gas production in Russia over the past three years and the lack of funds for parallel construction of pipelines and development of new fields could lead to attempts to redistribute flows from producing fields. As a result, Ukraine could lose substantial transit volumes of Russian gas,

The European Union supports the pipeline link project, since its implementation would induce Gazprom to develop the Yamal reserves and would rule out the possibility of redirecting this gas to the APR, notably to China. At the same time, European companies would be able to make considerable profits from pipeline maintenance. The EU's interest in the project may also be due to its desire to help accelerate economic growth in the EU candidate countries and its urge to save some of the money to be allocated for evening out their economic levels.

Ukraine-Russia Cooperation

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Russia and Ukraine have been taking part in a joint project entered in EU programs in the gas field: an expansion of the throughput capacity of pipelines running from Russia to the Balkan countries and Turkey. Kiev is also directly involved in the joint work being done to expand the capacity of the Ananiev-Izmail route. In this way, Ukraine will be able to ensure the transit to these countries of up to 38 Bern of Russian gas a year.

The Ananiev-Izmail main pipeline and compressor stations are being designed by ZAO Gaztranzit. Phase one-the construction of the Tarutino Station-has already been completed, which makes it possible to increase throughput by 3.9 Bern. Preparatory work has been started on the second phase of the project: the construction of a second branch for the Ananiev-Tiraspol-Izmail pipeline.

On the strength of the above, one can draw the following conclusions. By 2010, the implementation of Russian projects bypassing Ukraine could already lead to a reduction in gas transit via Ukraine by more than 60 Bern a year. At the same time, an expansion of Ukraine's gas transport system under projects now in train could raise its capacity by 15-20 Bern a year.

Since the expenditures on the laying of new routes are times higher than the costs of expansion or fuller use of existing capacity (in view of additional geodetic and other survey works, land allotment, etc.), one can say that the decision of Russia and the EU to bypass the territory of Ukraine will mean higher prices for end users of gas in the EU, that it is largely subjective and is more politically motivated than otherwise.

Ukrainian Gas Transport System

In terms of capacity, length and complexity of facilities, Ukraine's gas transport system ranks second in the world (behind the Russian system). One of its specific features is the existence of powerful underground gas storage facilities, which make it possible to resolve the problems of seasonally varying demand for gas. The value of the Ukrainian GTS, according to various estimates, is $15-20 billion.

For many years now this system has enabled Ukraine to receive as payment for transit services around 30 Bern of Russian gas a year (which equals the republic's own annual requirements) for the amount of around $1.5bn (almost 10% of its export earnings). Payments into the state budget also come to an impressive amount: the projected figure for 2002 is 2.24bn hryvnas ($1 = 5.4 hryvnas).

The stable operation of the GTS is crucial to the energy security not only of Ukraine, but also of 18 European countries using Russian gas. Owing to a continual renewal and upgrading of this system, its basic equipment has been operating without significant failures. Over the past ten years, 5,100 km of main gas pipelines and 10 compressor plants have been built and put into service in the country. In 2001, the construction was completed of the Solokha booster compressor station in the Poltava Region, and two renovated compressor stations (Dolina and Uzhgorod) were put into operation. Work is in progress to renovate and modernize such main pipelines as Novopskov-Aksai-Mozdok, Dashava-Minsk, Shebelin-ka-Dnepropetrovsk-Odessa, Dolina-Uzhgorod-Gosgranitsa, and others.

Under a national program entitled Ukraine's Oil and Gas Until 2010, a total of $5,120m is to be allocated for renovating and modernizing the GTS. But these works are impeded by the significant tax burden and other deficiencies of government regulation. Unfortunately, despite the strategic importance of the gas industry, it is not being granted any preferential credits for the purchase of up-to-date equipment, modernization or new construction, no use is being made of guarantees or credit insurance, etc. The development of the GTS has not been designated as a priority line of the country's economic development, reforms in this area are being delayed, while obsolete and physically worn out equipment does not allow the system to reach its design capacity of 170 Bern.

True, systematic underfunding of renovation and overhaul works has not yet resulted in any disruptions in transit supply, but accidents and failures of rundown equipment are ever more likely.

Tactical Issues: Ukraine's Interests and Their Protection

In the context of further development of cooperation between Ukraine and the EU, let us consider the above-mentioned project for the construction of the Poland-Slovakia pipeline link. In fact, it is the only project for a gas pipeline bypassing our territory to which Ukraine has any objections. Moreover, it objects only to such a link being built without a parallel increase in the production and transportation of Russian gas, in which case the republic could suffer losses. And as a party to the European Energy Charter Treaty it has a right to safeguard its interests. As we have already noted, Russia and Belarus have not ratified the ECT, but the other participants in the pipeline link project-EU, Italy, Germany, Poland, Slovakia and France-are parties to the Treaty. That is why Ukraine may appeal to the European Energy Charter Conference.

The construction of the link goes against the principles of cooperation between the parties, as formulated in Section I of the Charter. In particular, it is at odds with the principle ofnondiscrimination and coordination of energy policies, since neither the EU nor other project participants who have ratified the Charter have coordinated with Ukraine either the policy of diversifying transit in general or the matter of building the Poland-Slovakia pipeline in particular. This may be seen as a breach of treaty obligations by some of the parties. Furthermore, if this route becomes operational prior to the development of gas fields in Yamal (a very real prospect), a part of the export flow of Russian gas could be redirected from the Ukrainian GTS to Belarus-Polish networks. This could also be assessed as discrimination against Ukraine's interests.

Article 2 of the ECT says: "This Treaty establishes a legal framework in order to promote long-term cooperation in the energy field, based on complementarities and mutual benefits..." But, first, with the implementation of the pipeline link project long-term cooperation will partly come to an end and, second, benefits will accrue to all the project participants except Ukraine, which will suffer considerable losses.

Article 7 of the ECT, which deals with transit standards, proclaims: "Each Contracting Party shall take the necessary measures to facilitate the transit of Energy Materials..." But the construction of the link will lengthen the route of gas transportation and complicate its supply to Europe, since it will be necessary to create a new gas transport infrastructure instead of using the existing one.

Consequently, Ukraine's recourse to international arbitration mechanisms within the ECT framework would be justified: such recourse is one of its rights as a party to the Treaty, protects its national interests, complies with the ECT legal regime, and does not aim at worsening relations with any country of the region or with the "gas triangle" partners.

Today the EU is switching its attention to a diversification of gas supply sources, as indicated by the entry on its list of priorities of the project for building a gas network from the Middle East and the Caspian countries. Such a position is in line with Ukraine's interests. Any differences between the partners can be settled through their joint participation in privatizing the Ukrainian GTS. The Czech Republic and Slovakia have already privatized their GTSs.

In order to bring the Ukrainian GTS up to European standards, it would make sense to specify the main lines of cooperation between Ukraine and the EU in the field of gas transportation: a reform of the republic's GTS, its renewal and modernization; development of an integrated gas accounting system; introduction of high-precision metering systems and devices; optimization of technological processes, and preparation of feasibility studies for new sources of gas supply to Ukraine and via its territory to the EU.

How soon Ukraine and the EU can go over from a dialog to the implementation of joint projects in the gas transport field will depend on the achievement of a balance of interests in the EU-Ukraine-Russia triangle, and also on the success of political and economic transformations in Ukraine.

Any delays in reform in the republic's gas sector and the absence of a firm and clear-cut position on the issue of bypass gas pipelines will leave Ukraine on the sidelines of pan-European processes in the development and liberalization of the gas market.

Strategic Issues: Reform of Ukraine's Gas Sector as the Key to a Productive Energy Dialog

Ukraine's efforts to develop multilateral relations with the EU and Russia in the field of transportation of energy resources must assume a strategic and more pragmatic character. Kiev wants to see these relations develop along the following lines: a search for a balance of political and economic interests in diversifying gas transport routes, prevention (or elimination) of any possible negative effects on the republic's economy that could be caused by EU enlargement processes or by EU and Russian intentions to build gas pipelines bypassing Ukraine; formulation and pursuit of a national gas transport policy with due regard for the transport strategies of the EU and Russia; state coordination of the use of diplomatic instruments to hold back the completion of bypass pipelines and provide support for Russia's projects designed to boost its gas production potential, on the one hand, and creation of own gas transport routes (which would supplement instead of conflicting with existing routes) and broader cooperation of Ukrainian companies with European and Russian companies, on the other.

Ukraine would also benefit from taking part not only in the implementation of short-term gas supply projects and contracts, but also in the development of a long-range gas transport strategy in Eurasia; from consultations between the parties and efforts to coordinate their positions (on the level of the appropriate EU, Russian and Ukrainian agencies) on matters of building transnational pipelines; from the attraction of European and Russian capital to modernize and expand its gas transport network; from cooperation in expanding EU gas networks through supply of equipment, provision of design and construction services, etc; from privatization of the national gas transport system (with the Ukrainian side retaining a stake of 50% + 1 share) and the establishment on that basis of a consortium with the participation of a Ukrainian company (transitor), Russia's OAO Gazprom (supplier) and Western companies (consumers).

The development of multilateral relations in the gas industry must be supplemented in a harmonious way with a deepening of Ukraine's bilateral ties with the EU, their upgrading to the level of the republic's associated membership in the Union and simultaneous accession to the WTO. Only then will Kiev be able to uphold its interests on an equal footing,

The development of multilateral relations in the gas industry must be supplemented in a harmonious way with a deepening of Ukraine's bilateral ties with the EU, their upgrading to the level of the republic's associated membership in the Union and simultaneous accession to the WTO. Only then will Kiev be able to uphold its interests on an equal footing, to avert threats in the energy field connected, in particular, with the construction of bypass pipelines, and duly to respond to such threats.

The republic's priorities must include support ofEU policy for the earliest possible ratification of the ECT by Russia and Belarus so as to promote competition in the export of natural gas between gas-producing CIS countries; matching (in terms of timetables and resources) Ukraine's entry into the EU as an associated member, its accession to the WTO and advancement of European projects in the energy industry, and also their matching with similar processes in Russia; harmonization of Ukraine's legislation with EU standards, development of a legislative framework and guaranteed rules for privatizing and operating enterprises in the industry (notably with foreign participation); an extension to Ukraine of EU aid programs (PHARE and others), increased funding of Ukrainian projects under the TACIS and INOGATE programs through efforts to make them more feasible, economically justified and attractive to our partners; preparation of feasibility studies for new projects, primarily in diversifying supply sources;
and inclusion of issues relating to the transit of energy resources on the list of priority lines of Ukraine's interaction with the EU at the level of interparliamentary cooperation.

In relations with Russia, Ukraine is not as interested in having Moscow give up the construction of bypass gas pipelines as in a faster buildup of Russia's gas production for the new pipelines with Kiev's participation. From this standpoint, our efforts must be aimed to provide support (at an international level) for Russian projects in developing the fields ofYamal and the continental shelf of Arctic seas, and to expand cooperation with Gazprom (development and supply of gas production and other equipment, provision of design services, etc.).

It is quite obvious that reforms in the gas sector both of Ukraine and of Russia are required, first and foremost, by these countries themselves rather than by the West. The trilateral energy dialog between the EU, Ukraine and Russia must not lead to a slowdown in the construction of gas pipelines, especially those bypassing Ukrainian territory, but to joint efforts to boost gas production and build pipelines that would be of benefit to all parties, and to integration of the energy complexes of Russia and Ukraine into the single European energy system, which would serve to enhance Europe's energy security.

Since no other subsector of the economy of the EU, Russia and Ukraine is so closely connected with and strongly dependent on cooperation as the transit of gas, the partners should regard broader cooperation in this area as a factor of Europe's overall energy security. Appreciating the striving of the EU and Russia to find new gas transport routes, Ukraine expects its partners to select economically viable and efficient transit options.

The pace at which Russia develops its reserves and the scale of foreign investment in its gas sector depend in large part on the state and development of gas transport systems routed toward Europe. At the same time, uninterrupted transmission of growing volumes of energy resources to the EU calls for the establishment of a long-term and transparent permanent-action mechanism for cooperation between all the interested entities of the EU, Russia and Ukraine. This is possible provided the European Union, its member countries, Russia, Ukraine and other interested states, international oil and gas companies and investors work out a common stand on the priorities of developing gas networks in Eurasia.

Amazing Push Forward or "St. Petersburg Impromptu

At a meeting in St. Petersburg on 9 June, 2002, presidents Leonid Kuchma of Ukraine and Vladimir Putin of Russia signed a statement on strategic partnership in the gas field and voiced their intention to set up, on a parity basis, a consortium for running and developing the gas transport system. There in St. Petersburg this initiative was also approved by Germany's Chancellor Gerhard Schroeder.

Although the governments of Ukraine and Russia have been requested to prepare agreements to that effect, most specialists of the two countries and international experts take a fairly skeptical view of that "ad hoc" decision. First, Ukraine's legal framework does not provide for the possibility of setting up consortia based on strategic facilities. Moreover, a number of Ukrainian laws expressly prohibit the privatization of GTS facilities, and the list of enterprises which may be granted into concession does not include such facilities either (transfer of an enterprise into trusteeship may be regarded as an element of concession, since the country's legislation does not provide for any other option). Second, such a turn of events without any preparation was a surprise to all, both in Ukraine and in Russia, to say nothing, for example, of Shell Corporation, which several years ago offered Kiev good money for a concession. Third, an international team of experts under the EU's INOGATE program was preparing a report on ways to raise the operational efficiency of the Ukrainian GTS, but its work at the time of the St. Petersburg understandings had yet to be completed. Fourth, the Ukrainian people were entitled to be told about the "new lot" of such a national asset as the GTS before anyone else, but that was not done.

The only state that has come out against a consortium is Belarus (most European oil and gas companies have expressed a desire to take part in it). In fact, Minsk has demanded that Moscow compensate its moral and economic losses connected with the "demise" of the idea on the construction of a bypass pipeline, since Russian officials have been saying in their comments that bypass projects are to be abandoned.

So, the benefits that could accrue to Ukraine from the "snap decision" made in St. Petersburg have not been explained to the Ukrainian public in clear and unambiguous terms. In this situation, passage through parliament of any document (law or international agreement) connected with the establishment of such a consortium is problematic. The attempt to resolve this important problem on impulse will probably prove to be a failure (after all, "improvisations" in the oil and gas sector often take long years to prepare). To thrash out the necessary decision, the parties concerned still have to do a great deal of painstaking work.